

Five ways President-Elect Donald Trump could move markets

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In a historic victory that shocked the political establishment and global financial markets alike, Donald J. Trump will become the 45th president of the United States. In an uncanny echo of the Brexit outcome, millions of Americans, frustrated with the country's direction, voted against the perceived status quo in the world's wealthiest and most powerful democracy. Yet lack of clarity on how the president-elect actually will govern poses both risks and opportunities for investors.

WHAT COULD A TRUMP PRESIDENCY LOOK LIKE?

Republican candidate Trump beat his Democratic opponent Hillary Clinton by a notable margin. The uncertainty around his policies has unnerved investors, at least initially. Global stock markets tumbled, the US dollar slid against major currencies, and US Treasuries and gold rallied as investors moved away from higher risk assets.

Now investors and international leaders must take measure. Americans will adjust to the style and tone of a self-proclaimed outsider in the White House. However, the Republican majority in both the House and the Senate means Trump stands a good chance of enacting much of his economic agenda. He could do that via the so-called budget reconciliation process, under which tax and spending changes can pass with a mere majority of the Senate, not 60 votes. Investors now spooked by Trump's election may find themselves surprised next summer by the economic stimulus Trump's Washington enacts.

While we expect market volatility to continue as investors adjust to the reality of a new balance in power in Washington, here are five key areas in which policy decisions could have an economic impact.

1. Infrastructure – more than just a wall

The president-elect has talked about an infrastructure plan of what could be at least US\$500 billion, based on his informal pledge to roughly "double" what his opponent campaigned on.

While many in the nation's capital are skeptical, this effort may well include some version of a border wall intended to staunch the flow of immigrants across the southern border of the US, a centerpiece of his campaign. In theory, the US could even give Mexico loan guarantees to borrow at very low interest rates to assist in its construction, thus making good on Trump's

promise to have Mexico "pay" for the wall. Such a huge project might come to be seen as a Keynesian-style jobs program on both sides of the border.

Meanwhile, the same drive that led Trump to put his name on skylines in New York and elsewhere seems likely to inspire the new president to embrace an infrastructure agenda that would leave his legacy imprinted on any number of new or repaired roads, bridges, tunnels, seaports, airports, sewer systems, electric grids and more. If a stimulus of the size he's discussed were to be dispersed over a five-year time frame, it could add up to half a percentage point to gross domestic product annually over the period.

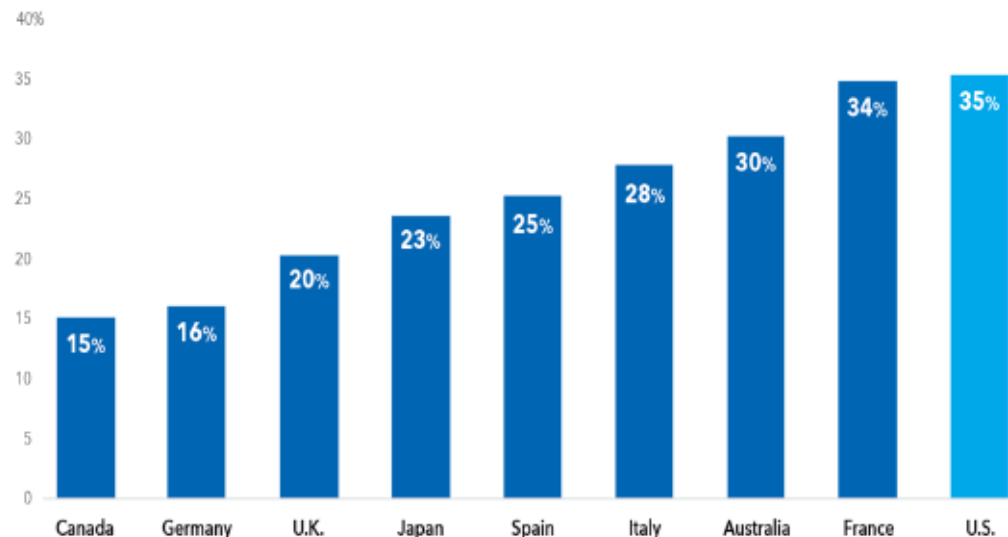
2. Taxes – lower rates for corporations and workers

Those infrastructure projects could be partially paid for through a corporate tax overhaul. Any such deal would likely include a provision to repatriate the estimated US\$2 trillion of US corporate earnings trapped overseas by taxing it on a one-time basis at a roughly 10% rate. This could entice companies to bring the cash back to the US.

Most Republicans and Democrats agree that the US corporate tax code needs reform. That makes it a prime candidate for bipartisan agreement and a potent early chance for Trump to showcase his negotiating skills. During his campaign, he pledged to cut the top marginal corporate tax rate to 15% from 35%, which should have the desirable side effect of curbing inversions — transactions that allow a US company to merge with an overseas firm and pay a lower tax rate in the latter's country. This practice has become popular over the past several years, much to the dismay of policymakers.

Trump has also pledged to dramatically lower personal income tax rates. If Trump has his way in the reconciliation process, the resulting blueprint – which would also include substantial defense increases – would spell higher budget deficits in the near term. More traditional Republican entitlement reformers, like Paul Ryan, will likely seek assurances from Trump that he'll return to these long-terms concerns within a few years.

Figure 1: National corporate income tax rates in 2016



Source: Organization for Economic Co-operation and Development.

3. Trade – considerable changes could be coming

A president has more unilateral power to make changes to current trade arrangements than is commonly understood. That means president-elect Trump could rewrite deals to be tougher on trade partners, or use the threat of US withdrawal from existing deals as a negotiating ploy to force changes in areas he deems important.

While the Washington establishment fears Trump will lead us into a destructive and recession-inducing trade war, that's hardly guaranteed. It seems more likely that Trump would see his and the country's interests better served by a posture that flexed some unused trade muscles to arrive at better terms at the margins.

In particular, Trump has pledged to revise the North American Free Trade Agreement, which was signed by his opponent's husband, President Bill Clinton, in 1993. He would also kill the Trans-Pacific Partnership, a result that would hurt America's prestige in the region. Finally, Trump has called for tougher rules on trade with China, which he says has taken advantage of US trade negotiators for years. He could also attempt in various ways to crack down on US firms that move jobs, plants or operations overseas.

4. Health care – repeal and rebrand the ACA

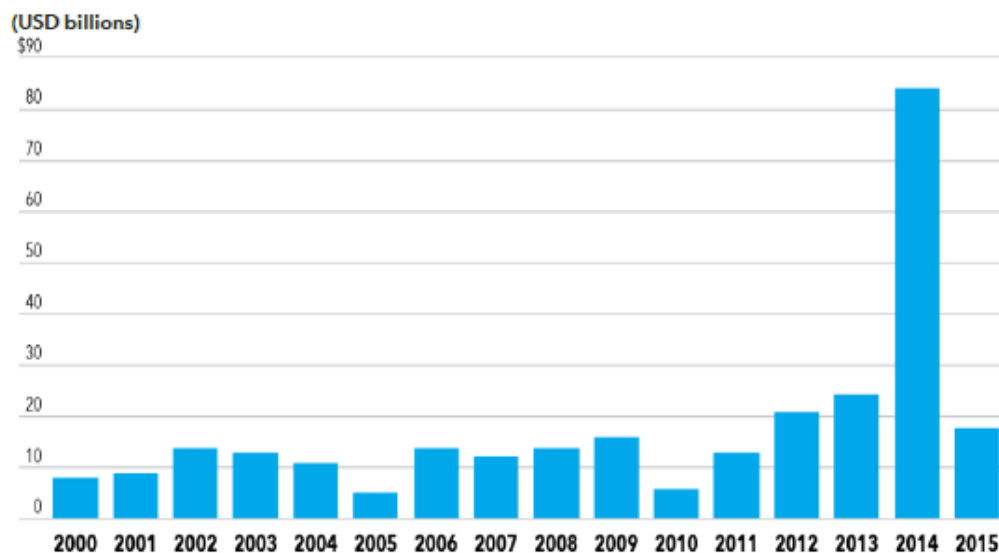
Although Trump has been vague about his precise plans for health care, he has campaigned on repealing the Affordable Care Act (ACA). Most observers believe, however, that it would be politically disastrous to simply cancel coverage for the 20 million Americans who've gotten health coverage under the ACA. So it's likely that the GOP plan to "repeal and replace" the law

will ultimately be implemented as a kind of "repeal and rebrand" – that is, some scaling back of subsidies and regulations Republicans find excessive while nonetheless holding the vast majority of current ACA beneficiaries harmless.

During the transition, there may be market jitters for hospital and health plans that depend on the ACA's subsidies and related supports. In the end, however, they should be able to flourish even after a GOP revamp.

During his campaign, Trump also criticised high drug prices, saying the government needs to be a stronger negotiator with pharmaceutical firms. If he follows through, that could mean a push for the government to exert its pricing power through Medicare, Medicaid and its other programs. However, the GOP more broadly is not aligned with Trump on the idea of direct price negotiations, so the outcome for now remains unclear.

Figure 2: Annual increase in consumer spending on health insurance

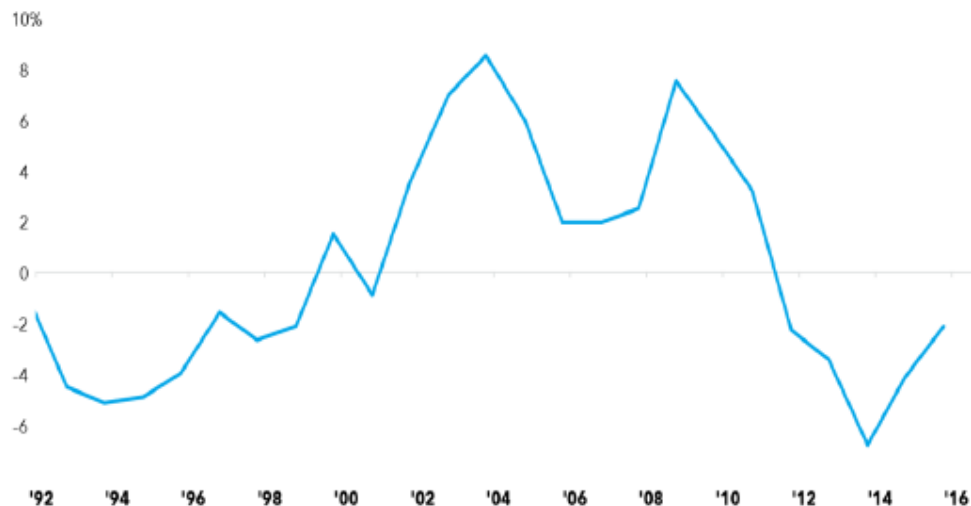


Sources: Bureau of Labor Statistics, Capital Group. 2015 data is a Capital Group estimate based on Bureau of Labor Statistics Consumer Expenditure Survey, 2015 Midyear Update.

5. Looser fiscal policy – a boon for defense contractors?

Trump has called for major defense spending increases, which would probably include beefing up defensive homeland security as well as offensive capabilities. That could signal something of a reversal from the Obama administration, which allowed defense spending to decline. Of course, if growth for such expenditures picks back up, it would be welcome news to big defense contractors in industries like aerospace.

Figure 3: Annual change in US real defense spending



Sources: Bureau of Economic Analysis, Thomson Reuters Datastream

THE LONG VIEW

Over the long run, the US economy is likely to remain one of the strongest globally, no matter who resides in the White House. Nevertheless, the president has the power to execute policy changes that can move markets.

While these five areas are some of the most significant in which the president-elect hopes to make changes, he and the new Congress can affect the economy in other ways as well. For example, Trump has said he'll roll back 2010's Dodd-Frank financial regulation law. Trump has also said that he would pull out of the Paris climate deal and undo environmental regulations to promote fracking and the coal mining industry. That could have a negative impact on renewable energy companies and a positive one on fossil fuel firms. These steps would also be highly controversial.

In the end, a Trump administration means a significant shift in Washington policy for at least the next four years. That could worry markets initially as they wait to see how a Trump presidency actually takes shape.

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